

## Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Unit Name	County
Fiscal Year End	Opinion Date	Date Audit Report Submitted to State	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).


YES  
NO

**Check each applicable box below.** (See instructions for further detail.)

1. ☐ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☐ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☐ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☐ ☐ The local unit has adopted a budget for all required funds.
5. ☐ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☐ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☐ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☐ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☐ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☐ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☐ ☐ The local unit is free of repeated comments from previous years.
12. ☐ ☐ The audit opinion is UNQUALIFIED.
13. ☐ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☐ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☐ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

<b>We have enclosed the following:</b>	Enclosed	Not Required (enter a brief justification)		
Financial Statements	<input type="checkbox"/>			
The letter of Comments and Recommendations	<input type="checkbox"/>			
Other (Describe)	<input type="checkbox"/>			
Certified Public Accountant (Firm Name)		Telephone Number		
Street Address		City	State	Zip
Authorizing CPA Signature 		Printed Name		License Number

# **City of Chelsea, Michigan**

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**Financial Report  
with Supplemental Information  
June 30, 2006**

# City of Chelsea, Michigan

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## Independent Auditor's Report

To the Members of the City Council  
City of Chelsea, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Chelsea, Michigan (the "City") as of June 30, 2006 and for the year then ended, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Chelsea, Michigan's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Chelsea, Michigan as of June 30, 2006 and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and the budgetary comparison schedules, as identified in the table of contents, are not a required part of the basic financial statements but are supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

To the Members of the City Council  
City of Chelsea, Michigan

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the City of Chelsea, Michigan's basic financial statements. The accompanying other supplemental information, as identified in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The other supplemental information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Plante & Moran, PLLC*

September 29, 2006

# City of Chelsea, Michigan

## Management's Discussion and Analysis

Our discussion and analysis of the City of Chelsea's (the "City") financial performance provides an overview of the City's financial activities for the year ended June 30, 2006. Please read it in conjunction with the City's financial statements.

### Financial Highlights

As discussed in further detail in this discussion and analysis, the following represents the most significant financial highlights for the year ended June 30, 2006:

- The fiscal year ending June 30, 2006 was the City's first 12-month fiscal year as a City and follows a 16-month transitional budget for the 16-month period ending June 30, 2005.
- The fund balance in the General Fund is slowly recovering after several years of decline. The fund balance increased from \$155,407 in 2005 to \$253,423 in 2006. The fund balance for the fiscal year ending June 30, 2006 is approximately 7.5 percent of actual General Fund expenditures.
- The City's support of the Chelsea Area Fire Authority exceeded the original budget of \$234,000 by nearly \$98,500. In February 2006, the City Council adopted a change in the Chelsea Area Fire Authority funding formula. Previously, the budget for the Chelsea Area Fire Authority was apportioned based on the member community's share of the total response hours for the previous year. A few major incidents in a community could result in a significant upswing in the community's share of the budget. A funding formula based on the response hours for the previous five-year period is expected to stabilize the wide variations in the funding apportionment.
- State-shared revenue, the City's second largest General Fund revenue source after property taxes, fell short of budget projections by \$20,441. The City received \$429,559 in state-shared revenue. For comparison purposes, the state-shared revenue received during 2006 decreased by \$3,898 compared to the state-shared revenue received from July 1, 2004 to June 30, 2005. State-shared revenue for 2004, from March 1, 2003 to February 29, 2004, was \$38,535 greater than the state-shared revenue received in 2006.

The Michigan Legislature continues to offset any gains in constitutional revenue sharing with decreases in statutory revenue sharing. The City needs to be more conservative in its projections of state-shared revenue.

The formula for statutory state-shared revenue expires on September 30, 2007. Some rumblings from the Legislature include placing strings on the issuance of statutory state-shared revenues, such as requiring municipalities to develop and implement performance standards and/or demonstrating regional cooperation in the delivery of services.

# City of Chelsea, Michigan

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## Management's Discussion and Analysis (Continued)

It is expected that counties and townships will seek to have their statutory state-shared revenue reinstated, which could lead to further reductions for cities and villages. The City may need to consider that statutory revenue sharing may ultimately be discontinued by the Legislature. Statutory state-shared revenue received by the City in 2006 was approximately \$129,000.

- Cash and cash equivalents in the Electric Fund decreased from \$300 in the previous year to \$0. In 2004, cash and cash equivalents in Electric Fund totaled \$513,120. It was necessary to borrow a total of \$235,654 from General Fund and Wastewater Fund cash to eliminate the deficit in the Electric Fund. The Electric Fund was able to pay back the borrowed funds shortly after the beginning of the 2007 fiscal year.

The cost-of-service study recommended an immediate increase in electric rates of an average of 15 percent. This increase was not implemented until March 2006. Due to a combination of a poor cash position in the Electric Fund coming into 2006 and not implementing the electric rate increase until March 2006, the Electric Fund ended the fiscal year with a cash shortfall. The Electric Fund's finances are expected to improve during the 2007 fiscal year.

- The Vehicle and Equipment Fund is an internal service fund. This fund includes expenses for wages and benefits for the City's mechanics, repairs and maintenance of City vehicles and equipment, and lease and capital outlay expenses for City vehicles and equipment in the police department and the Department of Public Works. This fund ended the fiscal year with a deficit of \$80,330.
- A deficit elimination plan will need to be filed with the State of Michigan. The primary reason for the deficit is lack of recordkeeping that would allow the wages, benefits, supplies, and repair and maintenance expenses to be charged back to the appropriate funds and budgets based on the work performed on vehicles and equipment in those funds. Addressing this recordkeeping and reporting problem is a priority task for the new public works superintendent.

### **Using this Annual Report**

This annual report consists of a series of financial statements. The statement of net assets and the statement of activities provide information about the activities of the City as a whole and present a longer-term view of the City's finances. This longer-term view uses the accrual basis of accounting so that it can measure the cost of providing services during the current year, and whether the taxpayers have funded the full cost of providing government services.

# City of Chelsea, Michigan

## Management's Discussion and Analysis (Continued)

The fund financial statements present a short-term view; they tell us how the taxpayers' resources were spent during the year, as well as how much is available for future spending. Fund financial statements also report the City's operations in more detail than the government-wide financial statements by providing information about the City's most significant funds. The fiduciary fund statements provide financial information about activities for which the City acts solely as a trustee or agent for the benefit of those outside of the government.

### The City as a Whole

The following table shows, in a condensed format, the net assets as of the current date and compared to the prior year:

	Governmental Activities		Business-type Activities		Total	
	2005	2006	2005	2006	2005	2006
<b>Assets</b>						
Current assets	\$ 4,070,667	\$ 3,556,469	\$ 2,681,022	\$ 2,628,198	\$ 6,751,689	\$ 6,184,667
Noncurrent assets	<u>40,091,918</u>	<u>39,171,502</u>	<u>27,802,940</u>	<u>27,271,728</u>	<u>67,894,858</u>	<u>66,443,230</u>
Total assets	44,162,585	42,727,971	30,483,962	29,899,926	74,646,547	72,627,897
<b>Liabilities</b>						
Current liabilities	885,029	638,381	1,918,469	1,515,824	2,803,498	2,154,205
Long-term liabilities	<u>2,992,824</u>	<u>2,732,665</u>	<u>8,810,000</u>	<u>8,138,000</u>	<u>11,802,824</u>	<u>10,870,665</u>
Total liabilities	<u>3,877,853</u>	<u>3,371,046</u>	<u>10,728,469</u>	<u>9,653,824</u>	<u>14,606,322</u>	<u>13,024,870</u>
<b>Net Assets</b>						
Invested in capital assets -						
Net of related debt	37,839,757	36,924,834	17,816,517	17,963,330	55,656,274	54,888,164
Restricted	2,086,846	2,151,090	436,111	498,398	2,522,957	2,649,488
Unrestricted	<u>358,129</u>	<u>281,001</u>	<u>1,502,865</u>	<u>1,784,374</u>	<u>1,860,994</u>	<u>2,065,375</u>
Total net assets	<u>\$ 40,284,732</u>	<u>\$ 39,356,925</u>	<u>\$ 19,755,493</u>	<u>\$ 20,246,102</u>	<u>\$ 60,040,225</u>	<u>\$ 59,603,027</u>

The City's combined net assets decreased approximately 1 percent from a year ago, decreasing from \$60.04 million to \$59.60 million. Total net assets related to the City's governmental activities decreased by 2.30 percent or \$927,807. Net capital assets being depreciated for governmental activities decreased by \$1,019,098.

Unrestricted net assets, the part of net assets that can be used to finance day-to-day operations, decreased by \$77,128 for the governmental activities. This represents a decrease of 21.54 percent. The current level of unrestricted net assets for the City's governmental activities is \$281,001, or 4.15 percent of total governmental expenditures. This is below a desired target level. Unrestricted net assets as a percentage of total governmental expenditures for the previous year was 5.30 percent and was 10.28 percent two years ago. Typically, a range of 20 percent to 30 percent is desired.



# City of Chelsea, Michigan

## Management's Discussion and Analysis (Continued)

The following table shows the changes of the net assets during the current year and as compared to the prior year:

	Governmental Activities		Business-type Activities		Total	
	2005	2006	2005	2006	2005	2006
<b>Net Assets - Beginning of year</b>	\$ 41,824,346	\$ 40,284,732	\$ 19,265,906	\$ 19,755,493	\$ 61,090,252	\$ 60,040,225
<b>Revenue</b>						
Program revenue:						
Charges for services	1,038,595	1,012,589	10,026,410	8,262,821	11,065,005	9,275,410
Capital grants and contributions	459,307	340,018	1,811,225	687,104	2,270,532	1,027,122
General revenue:						
Property taxes	2,973,344	2,972,899	77,596	176,237	3,050,940	3,149,136
State-shared revenue	583,151	434,942	-	-	583,151	434,942
Unrestricted investment earnings	175,093	155,538	41,365	63,980	216,458	219,518
Transfers and other revenue	(9,196)	(388,490)	9,196	388,490	-	-
Total revenue	5,220,294	4,527,496	11,965,792	9,578,632	17,186,086	14,106,128
<b>Program Expenses</b>						
General government	1,487,815	1,210,511	-	-	1,487,815	1,210,511
Public safety	1,409,600	1,187,637	-	-	1,409,600	1,187,637
Public works	3,514,004	2,698,217	-	-	3,514,004	2,698,217
Community and economic development	229,142	191,551	-	-	229,142	191,551
Recreation and culture	46,236	57,632	-	-	46,236	57,632
Interest on long-term debt	73,111	109,755	-	-	73,111	109,755
Water, sewer, and electric	-	-	11,476,205	9,088,023	11,476,205	9,088,023
Total program expenses	6,759,908	5,455,303	11,476,205	9,088,023	18,236,113	14,543,326
<b>Change in Net Assets</b>	(1,539,614)	(927,807)	489,587	490,609	(1,050,027)	(437,198)
<b>Net Assets - End of year</b>	<u>\$ 40,284,732</u>	<u>\$ 39,356,925</u>	<u>\$ 19,755,493</u>	<u>\$ 20,246,102</u>	<u>\$ 60,040,225</u>	<u>\$ 59,603,027</u>

### Governmental Activities

The City's total revenues for governmental activities were \$4,527,496, a decrease of 13.27 percent from the previous year.

Expenses were \$5,455,303 during the year, which is a decrease of 19.30 percent from the previous year. Many expenses decreased due to shift from the transitional 16-month period ended June 30, 2005 back to a 12-month fiscal year during 2006.

In the General Fund, the actual property tax revenues compared to the budgeted revenues show a shortfall of \$83,380. This variance is the result of the practice of applying property tax refunds and tax increment finance district transfers against budgeted revenues.

# City of Chelsea, Michigan

## Management's Discussion and Analysis (Continued)

City departments in the General Fund exceeded the original budget overall by \$6,257. This overrun is much less than the overruns experienced in 2005 of \$276,115 and \$108,562 in 2004.

Major expenditure overruns include Chelsea Area Fire Authority support, police wages, street lighting, parks wages, supplies and rentals, and salary-based fringe benefits payments such as Social Security, Medicare, and workers' compensation. These overruns were offset by postponing filling certain positions, postponing certain capital outlay projects, and smaller reductions in individual line items.

### **Business-type Activities**

The City's business-type activities consist of the Water, Sewer, and Electric Funds. The City provides water to residents from five groundwater wells and processes the water through a water treatment plant that provides iron removal and reverse osmosis softening. Sewage treatment is provided through a City-owned and operated sewage treatment plant. The City provides electrical service to its residents and businesses with power purchase agreements with the Michigan Public Power Agency and Constellation Energy. The City owns all of the substations and local electric transmission lines and, through the Michigan Public Power Agency, has part ownership of a regional transmission line.

In June 2005, the City contracted with Utility Financial Solutions to conduct a comprehensive cost-of-service study for its water, sewer, and electric utilities. The consultant recommended rate increases for all three utilities over the next five years. The first year recommended rate increases were not implemented until the March 2006 billing cycle.

The Electric Fund had an operating loss of \$226,120. According to the cost-of-service study, an average 15 percent increase in electric rates was required to give the infusion of cash needed by the Electric Fund. Since this substantial increase was not implemented until March 2006, the increase during the last four months of the fiscal year was only sufficient to address part of the loss.

The Wastewater (Sewer) Fund had an operating loss of \$530,177. The cost-of-service study recommended an average 9 percent increase in sewer rates. The increase in the last four months of the fiscal year only impacted part of the loss. The remainder of the loss was offset by customer connection fees. However, customer connection fees decreased significantly due to a development moratorium and a general slowdown in housing starts in the City.

The Water Fund recorded operating income of \$216,580. The income was the result of lower operating expenses and a small water rate increase in March 2006. The charges for services fell short of budget projections due to the implementation of the water rate increase being delayed to the last third of the fiscal year. The expense for professional services was significantly lower than budget due to an ongoing dispute with a vendor. The Water Fund was more conservative in its budget projections for revenue from customer connection fees. Even though the revenue projections fell short, the shortfall was not as significant as the connection fee shortfall in the Wastewater Fund.

# **City of Chelsea, Michigan**

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## **Management's Discussion and Analysis (Continued)**

### **The City's Funds**

Our analysis of the City's major funds follows the government-wide financial statements. The fund financial statements provide detail information about the most significant funds, not the City as a whole. The City Council creates funds to help manage money for specific purposes as well as to show accountability for certain activities, such as special property tax millages. The City's major funds for the current year include the General Fund, the Coliseum Drive Capital Project Fund, and Major Roads Fund.

An analysis of the General Fund was presented earlier in this discussion and analysis.

### **Capital Asset and Debt Administration**

As of June 30, 2006, the City had approximately \$65.6 million (net of depreciation) invested in a broad range of capital assets including roads, buildings, equipment, and water, sewer, and electric lines.

On November 30, 2004, Moody's Investor Service affirmed their A3 rating on the City's outstanding \$630,000 general obligation unlimited tax debt. The outstanding general obligation unlimited tax debt as of June 30, 2006 is \$330,000.

More detailed information concerning capital assets and long-term debt can be found in Notes 4 and 6, respectively, in the notes to the financial statements.

### **Economic Factors and Next Year's Budgets and Rates**

The City's 2005-2006 fiscal year budget was able to maintain the same property tax rate. This is primarily the result of growth in the City's taxable value. A state-imposed moratorium on new water lines was lifted in March 2006. In March 2006, the City Council directed that one of two reverse osmosis units be shut down in order to free capacity in the wastewater system. These combined actions allowed development in the City to proceed. However, a general slowdown in housing starts in the City, region, and State has resulted in developers cutting back on their development timetables.

The City's commercial and industrial areas continue to be viable. The City's downtown and commercial area on Main Street south of Old US-12 continues to have low vacancy rates. Renovation of the Clocktower Commons building in the Clocktower complex is substantially complete and the developer is working on attracting business to those spaces. A couple of large spaces in the Clocktower complex have been filled with new or expanded businesses. The Rockwell Building on this site is currently under renovation ahead of schedule.

The City Council will be requested to increase utility rates in the coming fiscal year. Although, the overall rate increases are expected to be less than those implemented in March 2006.

# **City of Chelsea, Michigan**

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## **Management's Discussion and Analysis (Continued)**

The City is exploring options for a new municipal office facility, police station, and a possible public works building expansion. These projects may require the issuance of bonds.

The City is proceeding to expand the wastewater treatment plant and make other improvements in the wastewater system using grants and loans under the Michigan State Revolving Loan Fund program. Construction on the expansion is expected to begin in 2007.

### **Contacting the City's Management**

This financial report is intended to provide our citizens, taxpayers, customers, and investors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional information, we welcome you to contact the City's office.

# City of Chelsea, Michigan

## Statement of Net Assets June 30, 2006

	Primary Government			Component
	Governmental	Business-type		Units
	Activities	Activities	Total	
<b>Assets</b>				
Cash and investments (Note 2)	\$ 2,390,692	\$ 1,153,858	\$ 3,544,550	\$ 251,572
Receivables:				
Taxes	96,970	-	96,970	-
Customers	29,334	1,183,353	1,212,687	-
Special assessments (Note 3)	635,136	-	635,136	-
Other	48,607	-	48,607	1,249
Internal balances	159,312	(159,312)	-	-
Due from component units (Note 5)	4,779	-	4,779	-
Due from other governmental units	191,639	-	191,639	-
Inventories	-	446,333	446,333	-
Prepaid costs and other assets	-	3,966	3,966	-
Restricted assets (Note 7)	-	498,398	498,398	-
Investment in joint ventures (Note 10)	391,980	-	391,980	-
Capital assets - Net (Note 4):				
Nondepreciated	4,539,575	1,784,331	6,323,906	586,737
Depreciated	34,239,947	24,988,999	59,228,946	1,791,559
Total assets	42,727,971	29,899,926	72,627,897	2,631,117
<b>Liabilities</b>				
Accounts payable	89,251	557,981	647,232	19
Accrued and other liabilities	173,990	185,843	359,833	105
Due to primary government (Note 5)	-	-	-	4,779
Noncurrent liabilities (Note 6):				
Due within one year	375,140	772,000	1,147,140	130,000
Due in more than one year	2,732,665	8,138,000	10,870,665	430,000
Total liabilities	3,371,046	9,653,824	13,024,870	564,903
<b>Net Assets</b>				
Invested in capital assets - Net of related debt	36,924,834	17,963,330	54,888,164	1,818,296
Restricted:				
Streets and highways	1,627,239	-	1,627,239	-
Law enforcement	189,594	-	189,594	-
Solid waste activities	213,771	-	213,771	-
Storm water utility	82,796	-	82,796	-
Debt service	-	498,398	498,398	-
Capital projects	37,690	-	37,690	-
Unrestricted	281,001	1,784,374	2,065,375	247,918
Total net assets	<u>\$ 39,356,925</u>	<u>\$ 20,246,102</u>	<u>\$ 59,603,027</u>	<u>\$ 2,066,214</u>

# City of Chelsea, Michigan

		Program Revenues		
		Charges for	Operating	Capital Grants
	Expenses	Services	Grants and Contributions	and Contributions
<b>Functions/Programs</b>				
Primary government:				
Governmental activities:				
General government	\$ 1,210,511	\$ 414,216	\$ 15,953	\$ -
Public safety	1,187,637	-	18,928	-
Public works	2,698,217	562,503	305,137	-
Community and economic development	191,551	35,870	-	-
Recreation and culture	57,632	-	-	-
Interest on long-term debt	109,755	-	-	-
Total governmental activities	5,455,303	1,012,589	340,018	-
Business-type activities:				
Water	1,399,424	1,375,232	-	366,403
Sewer	1,318,919	749,240	-	320,701
Electric	6,369,680	6,138,349	-	-
Total business-type activities	9,088,023	8,262,821	-	687,104
Total primary government	<u>\$ 14,543,326</u>	<u>\$ 9,275,410</u>	<u>\$ 340,018</u>	<u>\$ 687,104</u>
Component unit - Downtown				
Development Authority	<u>\$ 161,770</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
General revenues:				
Property taxes				
State-shared revenues				
Unrestricted investment earnings				
Transfers				
Total general revenues and transfers				
<b>Change in Net Assets</b>				
<b>Net Assets - Beginning of year</b>				
<b>Net Assets - End of year</b>				

**Statement of Activities**  
**Year Ended June 30, 2006**

Net (Expense) Revenue and Changes in Net Assets			
Primary Government			Component Units
Governmental Activities	Business-type Activities	Total	
\$ (780,342)	\$ -	\$ (780,342)	\$ -
(1,168,709)	-	(1,168,709)	-
(1,830,577)	-	(1,830,577)	-
(155,681)	-	(158,401)	-
(57,632)	-	(57,632)	-
(109,755)	-	(109,755)	-
(4,102,696)	-	(4,105,416)	-
-	342,211	342,211	-
-	(248,978)	(248,978)	-
-	(231,331)	(231,331)	-
-	(138,098)	(138,098)	-
(4,102,696)	(138,098)	(4,243,514)	-
-	-	-	(161,770)
2,972,899	176,237	3,149,136	250,549
434,942	-	434,942	-
155,538	63,980	219,518	1,381
(388,490)	388,490	-	-
3,174,889	628,707	3,803,596	251,930
(927,807)	490,609	(437,198)	90,160
40,284,732	19,755,493	60,040,225	1,976,054
<b>\$ 39,356,925</b>	<b>\$ 20,246,102</b>	<b>\$ 59,603,027</b>	<b>\$ 2,066,214</b>

# City of Chelsea, Michigan

## Governmental Funds Balance Sheet June 30, 2006

	Major Funds				Total Governmental Funds
	General	Coliseum Drive	Major Roads	Other Nonmajor Funds	
<b>Assets</b>					
Cash and investments (Note 2)	\$ 1,149	\$ 37,690	\$ 805,075	\$ 1,546,778	\$ 2,390,692
Receivables:					
Taxes	84,666	-	-	12,304	96,970
Customers	-	-	-	29,334	29,334
Special assessments (Note 3)	-	635,136	-	-	635,136
Other	48,567	-	-	-	48,567
Due from other funds (Note 5)	247,676	-	-	50	247,726
Due from component units (Note 5)	4,345	-	-	-	4,345
Due from other governmental units	56,734	-	38,879	13,737	109,350
Total assets	<u>\$ 443,137</u>	<u>\$ 672,826</u>	<u>\$ 843,954</u>	<u>\$ 1,602,203</u>	<u>\$ 3,562,120</u>
<b>Liabilities and Fund Balances</b>					
<b>Liabilities</b>					
Accounts payable	\$ 61,743	\$ -	\$ 13,467	\$ 8,245	\$ 83,455
Accrued and other liabilities	127,921	-	-	22,839	150,760
Due to other funds (Note 5)	50	-	12,311	8,794	21,155
Deferred revenue (Note 3)	-	635,136	-	-	635,136
Total liabilities	189,714	635,136	25,778	39,878	890,506
<b>Fund Balances</b>					
Reserved for:					
Streets and highways	-	-	-	-	-
Law enforcement	-	-	-	189,594	189,594
Solid waste maintenance	-	-	-	213,771	213,771
Storm water utility	-	-	-	82,796	82,796
Unreserved, reported in:					
General Fund	253,423	-	-	-	253,423
Special Revenue Funds	-	-	818,176	809,063	1,627,239
Capital Projects Funds	-	37,690	-	267,101	304,791
Total fund balances	253,423	37,690	818,176	1,562,325	2,671,614
Total liabilities and fund balances	<u>\$ 443,137</u>	<u>\$ 672,826</u>	<u>\$ 843,954</u>	<u>\$ 1,602,203</u>	<u>\$ 3,562,120</u>



# City of Chelsea, Michigan

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## Governmental Funds Reconciliation of Fund Balances of Governmental Funds to the Statement of Net Assets Year Ended June 30, 2006

<b>Total Fund Balances of Governmental Funds</b>	\$ 2,671,614
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Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and are not reported in the funds	38,779,522
--	------------

Revenue sharing due from the State not received within 60 days of year end is not available currently and is not recorded in the funds	82,289
--	--------

Special assessment receivables are expected to be collected over several years and are not available to pay for current year expenditures	635,136
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Long-term liabilities are not due and payable in the current period and are not reported in the funds	(3,107,805)
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Investments in joint ventures are not financial resources and are not reported in the funds	391,980
---	---------

Interest amounts on long-term liabilities are not payable until due in the funds	(15,481)
--	----------

Internal Service Funds are included as part of governmental activities	<u>(80,330)</u>
--	-----------------

<b>Net Assets of Governmental Activities</b>	<b><u>\$ 39,356,925</u></b>
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# City of Chelsea, Michigan

## Governmental Funds Statement of Revenue, Expenditures, and Changes in Fund Balances Year Ended June 30, 2006

	Major Funds			Other	Total
	General	Coliseum Drive	Major Roads	Nonmajor Funds	Governmental Funds
<b>Revenue</b>					
Property taxes	\$ 2,540,700	\$ -	\$ -	\$ 432,199	\$ 2,972,899
Special assessments	-	45,366	-	-	45,366
State sources	434,718	-	242,322	62,815	739,855
Local sources	-	-	-	18,928	18,928
License and permits	249,999	-	-	-	249,999
Charges for services	9,181	-	-	499,503	508,684
Fines and forfeitures	11,443	-	-	-	11,443
Interest and other	217,130	43,074	42,526	42,700	345,430
Total revenue	3,463,171	88,440	284,848	1,056,145	4,892,604
<b>Expenditures</b>					
General government	809,552	-	5,822	227,039	1,042,413
Public safety	1,064,296	-	-	-	1,064,296
Public works	547,211	-	304,884	449,601	1,301,696
Parks and recreation	57,032	-	-	-	57,032
Planning and zoning	191,551	-	-	-	191,551
Employee benefits and insurance	666,099	-	-	-	666,099
Debt service	-	87,038	-	365,737	452,775
Total expenditures	3,335,741	87,038	310,706	1,042,377	4,775,862
<b>Excess of Revenue Over (Under)</b>					
<b>Expenditures</b>	127,430	1,402	(25,858)	13,768	116,742
<b>Other Financing Sources (Uses)</b>					
Transfers in (Note 5)	15,000	-	55,511	274,053	344,564
Transfers out (Note 5)	(44,414)	-	-	(688,640)	(733,054)
Proceeds from the issuance of debt	-	-	-	63,000	63,000
Total other financing sources (uses)	(29,414)	-	55,511	(351,587)	(325,490)
<b>Net Change in Fund Balances</b>	98,016	1,402	29,653	(337,819)	(208,748)
<b>Fund Balances - Beginning of year</b>	155,407	36,288	788,523	1,900,144	2,880,362
<b>Fund Balances - End of year</b>	<u>\$ 253,423</u>	<u>\$ 37,690</u>	<u>\$ 818,176</u>	<u>\$ 1,562,325</u>	<u>\$ 2,671,614</u>

# City of Chelsea, Michigan

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## Governmental Funds Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities Year Ended June 30, 2006

**Net Change in Fund Balances - Total Governmental Funds** \$ (208,748)

Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlays as expenditures; in the statement of activities, these costs are allocated over their estimated useful lives as depreciation (1,266,905)

Revenue sharing is recorded in the statement of activities when the revenue is earned; it is not reported in the funds until collected or collectible within 60 days of year end 224

Special assessment revenues are recorded in the statement of activities when the assessment is set; they are not reported in the funds until collected or collectible within 60 days of year end (45,366)

Repayment of bond principal is an expenditure in the governmental funds, but not in the statement of activities (where it reduces long-term debt) - Net of proceeds 297,593

Change in accumulated employee sick and vacation pay is recorded when earned in the statement of activities 41,810

Payment of landfill postclosure costs is an expenditure in the governmental funds, but not in the statement of activities (where it reduces the long-term liability) 60,000

Change in the equity interest in the Chelsea Area Construction Agency is not reported in the governmental funds 33,520

Change in the equity interest in the Chelsea Area Fire Authority is not reported in the governmental funds 65,162

Accrued interest payable is recorded when due in governmental funds 4,834

Internal Service Funds are also included as governmental activities 90,069

**Change in Net Assets of Governmental Activities** \$ (927,807)

# City of Chelsea, Michigan

## Proprietary Funds Statement of Net Assets June 30, 2006

	Enterprise Funds - Major Funds				Internal Service Fund
	Water	Sewer	Electric	Total Major Funds	
<b>Assets</b>					
Current assets:					
Cash and cash equivalents (Note 2)	\$ 458,233	\$ 695,625	\$ -	\$ 1,153,858	\$ -
Receivables:					
Customers	187,732	96,870	898,751	1,183,353	-
Other	-	-	-	-	40
Due from component units (Note 5)	-	-	-	-	434
Due from other funds (Note 5)	-	253,165	-	253,165	4,083
Inventories	74,973	-	371,360	446,333	-
Prepaid costs and other assets	-	3,966	-	3,966	-
Total current assets	720,938	1,049,626	1,270,111	3,040,675	4,557
Long-term assets:					
Restricted assets (Note 7)	209,985	288,413	-	498,398	-
Capital assets (Note 4)	11,445,147	12,047,633	3,280,550	26,773,330	464,204
Total assets	12,376,070	13,385,672	4,550,661	30,312,403	468,761
<b>Liabilities</b>					
Current liabilities:					
Current portion of long-term liabilities	440,805	281,034	50,161	772,000	43,140
Accounts payable	81,942	42,851	433,188	557,981	5,796
Accrued and other liabilities	82,426	11,611	91,806	185,843	7,749
Due to other funds (Note 5)	-	-	412,477	412,477	71,342
Total current liabilities	605,173	335,496	987,632	1,928,301	128,027
Long-term liabilities - Net of current portion	7,750,172	387,828	-	8,138,000	214,141
Total liabilities	8,355,345	723,324	987,632	10,066,301	342,168
<b>Net Assets</b>					
Investment in capital assets - Net of related debt	3,260,147	11,422,633	3,280,550	17,963,330	206,923
Restricted for bond reserves/debt service	209,985	288,413	-	498,398	-
Unrestricted	550,593	951,302	282,479	1,784,374	(80,330)
Total net assets	<u>\$ 4,020,725</u>	<u>\$ 12,662,348</u>	<u>\$ 3,563,029</u>	<u>\$ 20,246,102</u>	<u>\$ 126,593</u>

# City of Chelsea, Michigan

## Proprietary Funds Statement of Revenue, Expenses, and Changes in Net Assets Year Ended June 30, 2006

	Enterprise Funds - Major Funds				Internal Service Fund
	Water	Sewer	Electric	Total Major Funds	
<b>Operating Revenue</b>					
Charges for services	\$ 1,332,176	\$ 740,931	\$ 6,093,309	\$ 8,166,416	\$ 356,736
Other	43,056	8,309	45,040	96,405	4,898
Total operating revenue	1,375,232	749,240	6,138,349	8,262,821	361,634
<b>Operating Expenses</b>					
Cost of electricity	-	-	4,719,868	4,719,868	-
Operation and maintenance	269,227	289,692	182,314	741,233	108,575
General and administrative	351,016	425,238	778,286	1,554,540	121,912
Professional/Contractor services	89,636	97,410	93,106	280,152	-
Payment in lieu of taxes	-	-	351,000	351,000	-
Depreciation and amortization	357,547	383,285	209,371	950,203	40,773
Other	91,226	83,792	30,524	205,542	729
Total operating expenses	1,158,652	1,279,417	6,364,469	8,802,538	271,989
<b>Operating Income (Loss)</b>	216,580	(530,177)	(226,120)	(539,717)	89,645
<b>Nonoperating Revenue (Expense)</b>					
Property taxes	-	176,237	-	176,237	-
Interest income	11,169	46,634	6,177	63,980	424
Interest expense	(240,772)	(39,502)	(5,211)	(285,485)	-
Total nonoperating revenue (expense)	(229,603)	183,369	966	(45,268)	424
<b>Income (Loss) - Before transfers and capital contributions</b>	(13,023)	(346,808)	(225,154)	(584,985)	90,069
<b>Other Financing Sources (Uses)</b>					
Transfers in (Note 5)	-	57,541	375,588	433,129	-
Transfers out (Note 5)	(15,181)	(29,458)	-	(44,639)	-
Total other financing sources (uses)	(15,181)	28,083	375,588	388,490	-
<b>Capital Contributions - Customer connection fees</b>	366,403	320,701	-	687,104	-
<b>Change in Net Assets</b>	338,199	1,976	150,434	490,609	90,069
<b>Net Assets - Beginning of year</b>	3,682,526	12,660,372	3,412,595	19,755,493	36,524
<b>Net Assets - End of year</b>	<u>\$ 4,020,725</u>	<u>\$ 12,662,348</u>	<u>\$ 3,563,029</u>	<u>\$ 20,246,102</u>	<u>\$ 126,593</u>

# City of Chelsea, Michigan

## Proprietary Funds Statement of Cash Flows Year Ended June 30, 2006

	Enterprise Funds - Major Funds			Internal Service Fund
	Water	Sewer	Electric	
<b>Cash Flows from Operating Activities</b>				
Receipts from customers	\$ 1,396,432	\$ 750,982	\$ 6,002,083	\$ 363,866
Payments to suppliers	(552,330)	(596,479)	(5,377,467)	(139,880)
Payments to employees	(232,381)	(306,528)	(506,105)	(89,329)
Internal activity - Payments to other funds in lieu of taxes	-	-	(351,000)	-
Net cash provided by (used in) operating activities	611,721	(152,025)	(232,489)	134,657
<b>Cash Flows from Noncapital Financing Activities</b>				
Internal activity - Payments to other funds	(14)	(253,165)	158,135	(39,919)
Transfers to other funds	(15,181)	(29,458)	-	-
Net cash provided by (used in) noncapital financing activities	(15,195)	(282,623)	158,135	(39,919)
<b>Cash Flows from Capital and Related Financing Activities</b>				
Collection of customer assessments (principal and interest)	-	85,358	-	-
Collection of property taxes	-	176,237	-	-
Transfers from other funds	-	57,541	375,588	-
Connection fees	366,403	320,701	-	-
Purchase of capital assets	(71,087)	(73,429)	(212,188)	(288,580)
Proceeds from issuance of long-term debt	-	-	-	239,002
Principal and interest paid on capital debt	(944,332)	(279,502)	(95,523)	(45,584)
Net cash provided by (used in) capital and related financing activities	(649,016)	286,906	67,877	(95,162)
<b>Cash Flows from Investing Activities - Interest received on investments</b>	11,169	32,257	6,177	424
<b>Net Decrease in Cash and Cash Equivalents</b>	(41,321)	(115,485)	(300)	-
<b>Cash and Cash Equivalents - Beginning of year</b>	709,539	995,966	300	-
<b>Cash and Cash Equivalents - End of year</b>	<b>\$ 668,218</b>	<b>\$ 880,481</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Balance Sheet Classification of Cash and Cash Equivalents and Restricted Cash</b>				
Cash and investments	\$ 458,233	\$ 695,625	\$ -	\$ -
Restricted investments (Note 7)	209,985	184,856	-	-
<b>Total cash and cash equivalents</b>	<b>\$ 668,218</b>	<b>\$ 880,481</b>	<b>\$ -</b>	<b>\$ -</b>

# City of Chelsea, Michigan

## Proprietary Funds Statement of Cash Flows (Continued) Year Ended June 30, 2006

	Enterprise Funds - Major Funds			Internal Service Fund
	Water	Sewer	Electric	
<b>Reconciliation of Operating Income (Loss) to Net Cash from Operating Activities</b>				
Operating income (loss)	\$ 216,580	\$ (530,177)	\$ (226,120)	\$ 89,645
Adjustments to reconcile operating income (loss) to net cash from operating activities:				
Depreciation and amortization	357,547	383,285	209,371	40,773
Changes in assets and liabilities:				
Customer receivables	21,200	1,742	(143,315)	2,232
Prepaid and other assets	-	567	-	(434)
Due from other funds	-	-	-	-
Inventories	5,716	-	25,784	-
Accounts payable	9,726	(13,828)	(111,056)	1,982
Accrued and other liabilities	952	6,386	12,847	459
Net cash provided by (used in)				

**Noncash Investing, Capital, and Financing Activities** - During the year ended June 30, 2006, there were no noncash activities.

# City of Chelsea, Michigan

## Component Units Statement of Net Assets June 30, 2006

	Downtown Development Authority	Economic Development Corporation	Total
<b>Assets</b>			
Cash and investments (Note 2)	\$ 250,676	\$ 896	\$ 251,572
Receivables	1,249	-	1,249
Capital assets (Note 4)	2,378,296	-	2,378,296
Total assets	2,630,221	896	2,631,117
<b>Liabilities</b>			
Accounts payable	19	-	19
Accrued and other liabilities	105	-	105
Due to other funds	4,779	-	4,779
Noncurrent liabilities (Note 6):			
Due within one year	130,000	-	130,000
Due in more than one year	430,000	-	430,000
Total liabilities	564,903	-	564,903
<b>Net Assets</b>			
Investment in capital assets - Net of related debt	1,818,296	-	1,818,296
Unrestricted	247,022	896	247,918
Total net assets	<u>\$ 2,065,318</u>	<u>\$ 896</u>	<u>\$ 2,066,214</u>



# City of Chelsea, Michigan

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	Expenses	Program Revenues
Downtown Development Authority - Community and economic development	\$ 161,770	\$ -
Economic Development Corporation - Community and economic development	-	-
Total governmental activities	<u>\$ 161,770</u>	<u>\$ -</u>
General revenues:		
Property taxes		
Interest		
Total general revenues		
<b>Change in Net Assets</b>		
<b>Net Assets - Beginning of year</b>		
<b>Net Assets - End of year</b>		

**Component Units  
Statement of Activities  
Year Ended June 30, 2006**

Net (Expense) Revenue and Changes in Net Assets		
Downtown Development Authority	Economic Development Corporation	Total
\$ (161,770)	\$ -	\$ (161,770)
-	-	-
(161,770)	-	(161,770)
250,549	-	250,549
1,378	3	1,381
251,927	3	251,930
90,157	3	90,160
1,975,161	893	1,976,054
<b>\$ 2,065,318</b>	<b>\$ 896</b>	<b>\$ 2,066,214</b>

### **Note I - Summary of Significant Accounting Policies**

The accounting policies of the City of Chelsea, Michigan (the “City”) conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the significant accounting policies used by the City:

#### **Reporting Entity**

The City is governed by an elected seven-member council. The accompanying financial statements present the City and its component units, entities for which the City is considered to be financially accountable. Although blended component units are legally separate entities, in substance, they are part of the City’s operations. Each discretely presented component unit is reported in a separate column in the government-wide financial statements to emphasize that it is legally separate from the City (see discussion below for description).

#### **Blended Component Units**

The City of Chelsea Building Authority is governed by a board that is appointed by the City Council. Although it is legally separate from the City, it is reported as if it were part of the primary government because its sole purpose is to finance and construct City capital assets.

#### **Discretely Presented Component Units**

The following component units are reported within the component units column in the financial statements. They are reported in a separate column in the government-wide financial statements to emphasize that they are legally separate from the City.

- a. The Downtown Development Authority (the “Authority”) was created to correct and prevent deterioration in the downtown district, encourage historical preservation, and to promote economic growth within the downtown district. The Authority’s governing body, which consists of 13 individuals, is selected by the City president. In addition, the Authority’s budget is subject to approval by the City Council.
- b. The Economic Development Corporation (the “Corporation”) was created to provide means and methods for the encouragement and assistance of industrial and commercial enterprises in relocating, purchasing, constructing, improving, or expanding within the City so as to provide needed services and facilities of such enterprises to the residents of the City. The Corporation’s governing body, which consists of nine individuals, is selected by the City president.

### **Note I - Summary of Significant Accounting Policies (Continued)**

#### **Government-wide and Fund Financial Statements**

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include: (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenue.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual Enterprise Funds are reported as separate columns in the fund financial statements.

#### **Measurement Focus, Basis of Accounting, and Financial Statement Presentation**

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

### **Note I - Summary of Significant Accounting Policies (Continued)**

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available if it is collected within the current year or soon enough thereafter to pay liabilities of the current year. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal year. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, expenditures relating to compensated absences, and claims and judgments are recorded only when payment is due.

The City reports the following major governmental funds:

**General Fund** - The General Fund is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

**Coliseum Drive Fund** - The Coliseum Drive Fund is a Capital Project Fund that was created to account for the construction of the Coliseum Drive, funded through a special assessment.

**Major Roads Fund** - The Major Roads Fund is used to account for the resources of state gas and weight tax revenues that are restricted for use on major roads.

The City reports the following major proprietary funds:

**Water Fund** - The Water Fund accounts for the activities of the water distribution system, financed primarily by a user charge for the provision of those services.

**Sewer Fund** - The Sewer Fund accounts for the activities of the sewer collection system, financed primarily by a user charge for the provision of those services.

**Electric Fund** - The Electric Fund accounts for the activities of the electric distribution system, financed primarily by a user charge for the provision of those services.

Additionally, the City reports the following fund types:

**Special Revenue Funds** - Special Revenue Funds are used to account for the proceeds of earmarked revenue or financing activities requiring separate accounting because of legal or regulatory provisions.

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

**Capital Project Fund** - The Capital Project Fund is used to account for the construction of a new City office building. Revenues consist of interest income on investments and transfers from other funds for debt service.

**Debt Service Funds** - Debt Service Funds are used to account for the annual payment of principal, interest, and expenses in connection with certain long-term debt other than debt payable from the operations of an Enterprise Fund.

**Internal Service Fund** - The Internal Service Fund is used to account for major machinery and equipment purchases and maintenance provided to other departments of the City on a cost reimbursement basis.

Private sector standards of accounting issued prior to December 1, 1989 are generally followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with the standards of the Governmental Accounting Standards Board. The City has elected not to follow private sector standards issued after November 30, 1989 for its business-type activities.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges between the City's water, sewer, and electric functions and various other functions of the City. Eliminations of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of the City's proprietary funds relates to charges to customers for sales and services. Operating expenses for proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

#### **Property Tax Revenue**

All trade and property tax receivables are shown as net of allowance for uncollectible amounts. Property taxes are levied on each July 1 on the taxable valuation of property as of the preceding December 31. Taxes are considered delinquent on March 1 of the following year, at which time penalties and interest are assessed.

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

The 2005 taxable valuation of the City totaled approximately \$217,198,000 on which ad valorem taxes levied consisted of 10.4494 mills for the City's general operating purposes, 1.5246 mills for street improvements, 0.4369 mills for solid waste operations, and 0.8000 mills for sewer-related debt service. The ad valorem taxes levied raised approximately \$2,180,000 for operations (which are net of various refunds and TIFA transfers paid during the year ended June 30, 2006), approximately \$336,000 for street improvements, approximately \$98,000 for solid waste operations, and approximately \$176,000 for sewer-related debt service. In addition, the General Fund received various payments in lieu of taxes during the year approximating \$358,000. These amounts are recognized in the respective General Fund, Special Revenue Fund, and Debt Service Fund financial statements as tax revenue. The Downtown Development Authority is currently not capturing property taxes consistent with the provisions in Act 197 of 1975.

#### **Assets, Liabilities, and Net Assets or Equity**

**Bank Deposits and Investments** - Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value.

**Receivables and Payables** - In general, outstanding balances between funds are reported as "due to/from other funds." Activity between funds that is representative of lending/borrowing arrangements outstanding at the end of the fiscal year is referred to as "advances to/from other funds." Any residual balances outstanding between the governmental activities and the business-type activities are reported in the government-wide financial statements as "internal balances."

**Inventories** - Inventories are valued at cost, on a first-in, first-out basis.

**Restricted Assets** - The restricted assets in the Water and Sewer Funds consist of cash and cash equivalents, investments, and property tax and assessments receivable restricted to provide debt service principal and interest.

**Capital Assets** - Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities column in the government-wide financial statements. Capital assets are defined by the City as assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

### Note 1 - Summary of Significant Accounting Policies (Continued)

Buildings, equipment, and vehicles are depreciated using the straight-line method over the following useful lives:

Governmental activities:

Roads and sidewalks	11 to 50 years
Buildings and improvements	50 years
Vehicles	3 to 15 years
Equipment	5 to 20 years

Business-type activities:

Land improvements	20 years
Infrastructure	10 to 50 years
Vehicles	5 to 15 years
Equipment	5 to 10 years
Office equipment	5 to 10 years
Building	20 to 50 years
Water tower	10 to 50 years
Special assessment district	50 years

**Compensated Absences (Vacation and Sick Leave)** - It is the City's policy to permit employees to accumulate earned but unused sick and vacation pay benefits. All vacation and sick pay is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for these amounts is reported in governmental funds only for employee terminations as of year end.

**Long-term Obligations** - In the government-wide financial statements and the proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund-type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt. In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current year. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts are reported as other financing uses. Issuance costs are reported as debt service expenditures.



### **Note 1 - Summary of Significant Accounting Policies (Continued)**

**Fund Equity** - In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

**Comparative Data** - Comparative data is not included in the City's financial statements.

**Use of Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates.

### **Note 2 - Deposits and Investments**

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The City has designated four banks for the deposit of its funds. The investment policy adopted by the council in accordance with Public Act 196 of 1997 has authorized investment in bonds and securities of the United States government and bank accounts and CDs, commercial paper rated within the two highest classifications, with matures more than 270 days after the date of purchase, repurchase agreements, bankers' acceptances of U.S. banks, mutual funds, and investment pools. The City's deposits and investment policies are in accordance with statutory authority.

### Note 2 - Deposits and Investments (Continued)

The City's cash and investments are subject to several types of risk, which are examined in more detail below:

**Custodial Credit Risk of Bank Deposits** - Custodial credit risk is the risk that in the event of a bank failure, the City's deposits may not be returned to it. The City does not have a deposit policy for custodial credit risk. At year end, the City had \$3,581,272 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The City believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the City evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

**Credit Risk** - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The City has no investment policy that would further limit its investment choices. As of year end, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

<u>Investment</u>	<u>Fair Value</u>	<u>Rating</u>
Interlocal Agreement Fund	\$ 209,985	Not rated

### Note 3 - Receivables/Deferred Revenue

On the fund-based financial statements, governmental funds report deferred revenue in connection with receivables for revenue that is not considered to be available to liquidate liabilities of the current year. Governmental funds also defer revenue recognition in connection with resources that have been received but not yet earned. At the end of the current fiscal year, \$635,136 of the deferred revenue balance was comprised of special assessments, which are unavailable in the governmental funds.

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2006

### Note 4 - Capital Assets

Capital asset activity of the City's governmental and business-type activities was as follows:

	Balance July 1, 2005	Additions	Disposals	Balance June 30, 2006
<b>Governmental Activities</b>				
Capital assets not being depreciated -				
Land	\$ 4,539,575	\$ -	\$ -	\$ 4,539,575
Capital assets being depreciated:				
Roads and sidewalks	49,782,286	26,742	-	49,809,028
Buildings and improvements	693,076	53,600	-	746,676
Vehicles	507,519	136,580	(19,919)	624,180
Equipment	1,412,455	233,620	-	1,646,075
Subtotal	52,395,336	450,542	(19,919)	52,825,959
Accumulated depreciation:				
Roads and sidewalks	15,438,709	1,346,563	-	16,785,272
Buildings and improvements	303,740	10,333	-	314,073
Vehicles	398,025	23,972	(19,919)	402,078
Equipment	995,817	88,772	-	1,084,589
Subtotal	17,136,291	1,469,640	(19,919)	18,586,012
Net capital assets being depreciated	35,259,045	(1,019,098)	-	34,239,947
Net capital assets	<u>\$ 39,798,620</u>	<u>\$ (1,019,098)</u>	<u>\$ -</u>	<u>\$ 38,779,522</u>

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2006

### Note 4 - Capital Assets (Continued)

	Balance July 1, 2005	Additions	Disposals and Adjustments	Balance June 30, 2006
<b>Business-type Activities</b>				
Capital assets not being depreciated -				
Land	\$ 1,784,331	\$ -	\$ -	\$ 1,784,331
Capital assets being depreciated:				
Land improvements	45,500	-	-	45,500
Infrastructure	10,976,129	227,323	-	11,203,452
Vehicles	543,128	-	17,055	526,073
Equipment	12,970,899	81,738	-	13,052,637
Office equipment	91,863	-	-	91,863
Building	9,719,434	47,077	-	9,766,511
Water tower	510,306	-	-	510,306
Special assessment district	549,194	-	-	549,194
Subtotal	35,406,453	356,138	17,055	35,745,536
Accumulated depreciation:				
Land improvements	33,744	2,275	-	36,019
Infrastructure	3,952,699	258,764	-	4,211,463
Vehicles	384,736	37,071	17,055	404,752
Equipment	2,099,079	427,389	-	2,526,468
Office equipment	91,863	-	-	91,863
Building	3,066,848	201,443	-	3,268,291
Water tower	97,962	11,709	-	109,671
Special assessment district	97,024	10,986	-	108,010
Subtotal	9,823,955	949,637	17,055	10,756,537
Net capital assets being depreciated	25,582,498	(593,499)	-	24,988,999
Net capital assets	<u>\$ 27,366,829</u>	<u>\$ (593,499)</u>	<u>\$ -</u>	<u>\$ 26,773,330</u>

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2006

### Note 4 - Capital Assets (Continued)

Depreciation expense was charged to programs of the primary government as follows:

Governmental activities:

General government	\$ 6,610
Public safety	3,700
Public works	1,458,730
Recreation and culture	<u>600</u>

Total governmental activities	<u>\$ 1,469,640</u>
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Business-type activities:

Water	\$ 357,548
Sewer	382,718
Electric	<u>209,371</u>

Total business-type activities	<u>\$ 949,637</u>
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Capital asset activity of the City's component units was as follows:

	Balance July 1, 2005	Additions	Disposals and Adjustments	Balance June 30, 2006
<b>Component Units</b>				
Capital assets not being depreciated -				
Land	\$ 586,737	\$ -	\$ -	\$ 586,737
Capital assets being depreciated:				
Land improvements	1,951,530	-	-	1,951,530
Equipment	<u>112,974</u>	<u>52,970</u>	<u>-</u>	<u>165,944</u>
Subtotal	2,064,504	52,970	-	2,117,474
Accumulated depreciation:				
Land improvements	220,201	78,061	-	298,262
Equipment	<u>14,855</u>	<u>12,798</u>	<u>-</u>	<u>27,653</u>
Subtotal	<u>235,056</u>	<u>90,859</u>	<u>-</u>	<u>325,915</u>
Net capital assets being depreciated	<u>1,829,448</u>	<u>(37,889)</u>	<u>-</u>	<u>1,791,559</u>
Net capital assets	<u>\$ 2,416,185</u>	<u>\$ (37,889)</u>	<u>\$ -</u>	<u>\$ 2,378,296</u>

**Construction Commitments** - The City has no active construction projects at year end.

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2006

### Note 5 - Interfund Receivables, Payables, and Transfers

The composition of interfund balances is as follows:

Receivable Fund	Payable Fund	Amount
<b>Due to/from Other Funds</b>		
General Fund	Major Roads Fund	\$ 8,310
	Electric Fund	230,654
	Other nonmajor governmental funds	<u>8,712</u>
	Total General Fund	247,676
Other governmental funds	General Fund	<u>50</u>
	Total governmental funds	247,726
Proprietary fund - Sewer Fund	Electric Fund	181,823
	Vehicle and Equipment Fund	<u>71,342</u>
	Total Sewer Fund	253,165
Proprietary fund - Vehicle and Equipment Fund	Major Roads Fund	4,001
	Other nonmajor governmental funds	<u>82</u>
	Total Vehicle and Equipment Fund	<u>4,083</u>
	Total proprietary funds	<u>257,248</u>
	Total	<u><u>\$ 504,974</u></u>
<b>Due to/from Component Unit</b>		
General Fund	Downtown Development Authority	\$ 4,345
Vehicle and Equipment Fund	Downtown Development Authority	<u>434</u>
	Total	<u><u>\$ 4,779</u></u>

Interfund balances represent routine and temporary cash flow assistance resulting from normal interfund activity until the amounts can be reimbursed between the funds.

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2006

### Note 5 - Interfund Receivables, Payables, and Transfers (Continued)

#### Interfund Transfers

	Transfers Out				
				Other	Total
	General Fund	Water Fund	Sewer Fund	Governmental Funds	
Transfers in:					
General Fund (1)	\$ -	\$ -	\$ 15,000	\$ -	\$ 15,000
Major Roads Fund (1)	-	-	-	55,511	55,511
Electric Fund (2)	-	-	-	375,588	375,588
Sewer Fund (3)	-	-	-	57,541	57,541
Other governmental funds (1, 3)	44,414	15,181	14,458	200,000	274,053
Total	<u>\$ 44,414</u>	<u>\$ 15,181</u>	<u>\$ 29,458</u>	<u>\$ 688,640</u>	<u>\$ 777,693</u>

(1) Transfer for general operations

(2) Transfer for capital outlay

(3) Transfer for capital improvements and debt service on municipal building

### Note 6 - Long-term Debt

The City issues bonds to provide for the acquisition and construction of major capital assets. General obligation bonds are direct obligations and pledge the full faith and credit of the City. Installment purchase agreements are also general obligations of the government. Special assessment bonds provide for capital improvements that benefit specific properties, and will be repaid from amounts levied against those properties benefited from the construction. In the event that a deficiency exists because of unpaid or delinquent special assessments at the time a debt service payment is due, the City is obligated to provide these resources to cover the deficiency until other resources are received.

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2006

### Note 6 - Long-term Debt (Continued)

Long-term obligation activity can be summarized as follows:

	Interest Rate	Principal Maturity Ranges	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<b>Governmental Activities</b>							
General obligation bonds:							
1994 Limited Tax G.O. Bonds:							
Amount of issue - \$550,000							
Maturing through 2011	-	\$ -	\$ 270,000	\$ -	\$ 270,000	\$ -	\$ -
2000 Special Assessment:							
Limited Tax G.O. Bonds:							
Amount of issue - \$905,000	4.80% -	\$45,000 -					
Maturing through 2021	5.50%	\$50,000	715,000	-	50,000	665,000	50,000
2002 Limited Tax G.O. Bonds:							
Amount of issue - \$995,000	3.30% -	\$35,000 -					
Maturing through 2022	5.15%	\$80,000	910,000	-	30,000	880,000	35,000
Installment purchase agreements:							
Amount of issue - \$79,829	3.99%	\$14,194 -					
Maturing through 2009		\$15,966	63,863	-	12,999	50,864	15,966
Amount of issue - \$87,000	4.50%	\$10,800 -					
Maturing through 2012		\$13,555	-	87,000	14,185	72,815	10,800
Amount of issue - \$152,002	5.07%	\$16,374					
Maturing through 2013		\$22,031	-	152,002	18,400	133,602	16,374
Amount of issue - \$63,000	6.50%	\$4,336 -					
Maturing through 2010		\$15,000	-	63,000	10,593	52,407	15,000
Accumulated compensated absences			214,927	-	41,810	173,117	172,000
Landfill postclosure care costs			1,140,000	-	60,000	1,080,000	60,000
Total governmental activities			<u>\$ 3,313,790</u>	<u>\$ 302,002</u>	<u>\$ 507,987</u>	<u>\$ 3,107,805</u>	<u>\$ 375,140</u>



# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2006

### Note 6 - Long-term Debt (Continued)

	Interest Rate	Maturity Ranges	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<b>Business-type Activities</b>							
General obligation bonds:							
1993 Unlimited Tax G.O. Bonds:							
Amount of issue - \$1,450,000	4.80%	\$160,000 -					
Maturing through 2008	4.90%	\$170,000	\$ 480,000	\$ -	\$ 150,000	\$ 330,000	\$ 160,000
1993 Limited Tax G.O. Bonds:							
Amount of issue - \$750,000	4.80%	\$70,000 -					
Maturing through 2008	4.90%	\$75,000	210,000	-	65,000	145,000	75,000
1994 Special Assessment Bonds:							
Amount of issue - \$510,000	6.05%	\$20,000 -					
Maturing through 2013	6.45%	\$25,000	175,000	-	25,000	150,000	25,000
Revenue bonds - 1995 Water Supply							
System Revenue Bonds:							
Amount of issue - \$550,000	6.10%	\$30,000 -					
Maturing through 2015	6.50%	\$50,000	375,000	-	25,000	350,000	30,000
2000 Michigan Drinking Water							
Revolving Fund Program,							
\$9,200,000 available to be							
drawn, of which \$8,961,230							
has been drawn down,							
maturing through 2023							
	2.50%	\$395,000 - \$575,000	8,220,000	-	385,000	7,835,000	395,000
Installment purchase agreements:							
Amount of issue - \$435,000							
Maturing through 2018	-	\$ -	90,312	-	90,312	-	-
Accumulated compensated absences			94,846	5,154	-	100,000	87,000
Total business-type activities			<u>\$ 9,645,158</u>	<u>\$ 5,154</u>	<u>\$ 740,312</u>	<u>\$ 8,910,000</u>	<u>\$ 772,000</u>

Annual debt service requirements to maturity for the above bond and note obligations are as follows:

	Governmental Activities			Business-type Activities		
	Principal	Interest	Total	Principal	Interest	Total
2007	\$ 143,140	\$ 88,560	\$ 231,700	\$ 685,000	\$ 239,182	\$ 924,182
2008	145,473	82,813	228,286	700,000	214,307	914,307
2009	155,910	76,589	232,499	465,000	194,986	659,986
2010	125,706	70,231	195,937	480,000	181,123	661,123
2011	127,909	64,512	192,421	495,000	166,903	661,903
2012-2016	551,550	234,983	786,533	2,565,000	609,861	3,174,861
2017-2021	525,000	99,414	624,414	2,650,000	264,950	2,914,950
2022-2026	80,000	4,120	84,120	770,000	15,721	785,721
Total	<u>\$ 1,854,688</u>	<u>\$ 721,222</u>	<u>\$ 2,575,910</u>	<u>\$ 8,810,000</u>	<u>\$ 1,887,033</u>	<u>\$ 10,697,033</u>

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2006

### Note 6 - Long-term Debt (Continued)

**Landfill Postclosure Care Costs** - State and federal laws and regulations require the City to perform some remediation to the landfill site and to place a final cover on the landfill, as it no longer has the capacity to accept solid waste. Additionally, the City is required to perform certain maintenance and monitoring functions at the landfill site for 30 years after closure. As of February 28, 1995, all costs of closure have been incurred. Future monitoring costs are estimated by the City to approximate \$60,000 per year and the cost attributable to the remaining 18 years has been recorded as long-term debt. The City currently maintains a letter of credit in the amount of \$380,000 in favor of the Michigan Department of Natural Resources to be used to fund monitoring and remediation costs if they are not completed by the City. The City does not anticipate that the State of Michigan will utilize these funds.

**Component Units** - Long-term obligation activity for the component units can be summarized as follows:

	Interest Rate	Principal Maturity Ranges	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
General obligation bonds - 2000 Downtown Development Limited Tax G.O. Bonds:							
Amount of issue - \$995,000	5.05%-	\$130,000 -					
Maturing through 2011	5.20%	\$150,000	\$ 680,000	\$ -	\$ 120,000	\$ 560,000	\$ 130,000

Annual debt service requirements to maturity for the above component unit bond and note obligations are as follows:

	Principal	Interest	Total
2007	\$ 130,000	\$ 28,718	\$ 158,718
2008	135,000	22,153	157,153
2009	145,000	15,268	160,268
2010	150,000	7,800	157,800
Total	\$ 560,000	\$ 73,939	\$ 633,939

**No Commitment Debt** - Excluded from the City's financial statements are bonds issued by the Economic Development Corporation (the "Corporation"), a component unit of the City of Chelsea, Michigan. The amount of bonds outstanding at December 31, 2005, the most recent audit, totaled \$16,460,000.

### Note 6 - Long-term Debt (Continued)

The Corporation is organized pursuant to State of Michigan Act No. 338 of 1974, as amended. The primary purpose of the Corporation is to encourage and assist commercial and industrial enterprises to locate and expand facilities and services to the City of Chelsea, Michigan and its residents. This purpose is accomplished by the issuance of limited obligation revenue bonds by the Corporation. The Corporation issues limited obligation revenue bonds and, in effect, loans the bond proceeds to commercial and industrial enterprises to finance the cost of projects to be used by such enterprises. The bonds are sometimes, but not always, collateralized by a mortgage on the project or sale/leaseback documentation. In return, the benefited enterprise agrees to pay loan repayments or lease rental in amounts sufficient to pay debt service on the bonds.

The bonds issued by the Corporation are payable solely from the net revenue derived from the respective projects.

### Note 7 - Restricted Assets

The balances of the restricted asset accounts in the business-type activities are as follows:

	Business-type Activities		
	Water	Sewer	Total
Cash and cash equivalents	\$ 209,985	\$ 184,856	\$ 394,841
Assessments receivable	-	90,648	90,648
Property tax receivable	-	12,909	12,909
Total restricted assets	<u>\$ 209,985</u>	<u>\$ 288,413</u>	<u>\$ 498,398</u>

These assets are restricted for debt payments.

Current liability payable from restricted assets consists of the current portion of bonds payable relating to the construction of the Freer Road Sanitary Sewer System in the amount of \$185,000.

### **Note 8 - Risk Management**

The City is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The City has purchased commercial insurance for medical claims, and participates in the Michigan Municipal League Liability and Property Pool for claims relating to property loss, torts, errors and omissions, workers' compensation, and unemployment compensation. Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

The Michigan Municipal League Liability and Property Pool program operates as a common risk-sharing management program for local units of government in Michigan; member premiums are used to purchase commercial excess insurance coverage and pay member claims in excess of deductible amounts.

### **Note 9 - Defined Benefit Pension Plan and Postretirement Benefits**

**Plan Description** - The City participates in the Michigan Municipal Employees' Retirement System (MMERS), an agent multiple-employer defined benefit pension plan. The system provides retirement, disability, and death benefits to plan members and their beneficiaries. MMERS issues a publicly available financial report that includes financial statements and required supplementary information for the system. That report may be obtained by writing to MMERS at 1134 Municipal Way, Lansing, MI 48917.

**Funding Policy** - The obligation to contribute to and maintain the system for these employees was established by resolution of the City Council and negotiation with the City's competitive bargaining units.

**Annual Pension Costs** - For the year ended June 30, 2006, the City's annual pension cost of \$302,162 for the plan was equal to the required and actual contribution. The annual required contribution was determined as part of actuarial valuation at December 31, 2004, using the entry age cost method. Significant actuarial assumptions used include: (a) an 8 percent investment rate of return, (b) projected salary increases of 4.5 percent to 8.66 percent per year, depending on age, attributable to seniority/merit, and (c) the assumption that benefits will increase 2.5 percent per year (annually) after retirement, for certain retirees. Both (a) and (b) include an inflation component of 4.5 percent. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a four-year period. The unfunded actuarial liability is being amortized as a level percent of payroll on a closed basis. The remaining amortization period ranges from 25 to 27 years.

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2006

### Note 9 - Defined Benefit Pension Plan and Postretirement Benefits (Continued)

Three-year trend information is as follows:

	Fiscal Year Ended June 30 2006	16-month Period Ended June 30 2005	Fiscal Year Ended February 29 2004
Annual pension costs (APC)	\$ 302,162	\$ 366,868	\$ 271,348
Percentage of APC contributed	100%	100%	100%
		December 31	
	2005	2004	2003
Actuarial value of assets	\$ 4,988,510	\$ 4,685,122	\$ 4,405,088
Actuarial Accrued Liability (AAL)			
(entry age)	\$ 8,077,712	\$ 7,963,857	\$ 7,162,947
Unfunded AAL (UAAL)	\$ 3,089,202	\$ 3,278,735	\$ 2,757,859
Funded ratio	62%	59%	61%
Covered payroll	\$ 1,446,270	\$ 1,464,496	\$ 1,497,799
UAAL as a percentage of covered payroll	214%	224%	184%

### Defined Contribution Pension Plan

The City provides pension benefits to all of its full-time employees hired after September 9, 1997 and full-time employees hired prior to September 9, 1997 who elect to convert to this plan from the defined benefit pension plan. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. As established by resolution of the City Council and negotiation with the City's competitive bargaining units, the City contributes 7 percent of employees' gross earnings. Employees may contribute to the plan additional amounts on an after-tax basis. In accordance with these requirements, the City contributed \$95,985 and employees contributed \$14,370 during the current year.

### **Note 9 - Defined Benefit Pension Plan and Postretirement Benefits (Continued)**

**Postemployment Benefits** - The City provides health care benefits to all full-time employees upon retirement, in accordance with labor contracts and City Council resolution. Currently, nine retirees are eligible. The City includes pre-Medicare retirees and their dependents in its insured health care plan, with a contribution required by the participant. Expenditures for postemployment health care benefits are recognized as the insurance premiums become due; during the year, this amounted to approximately \$54,000.

The Governmental Accounting Standards Board has recently released Statement No. 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree health care, as well as any “other” postemployment benefits (other than pensions). The new rule will cause the government-wide financial statements to recognize the cost of providing retiree health care coverage over the working life of the employee, rather than at the time the health care premiums are paid. The new pronouncement is effective for the year ending June 30, 2009.

### **Note 10 - Joint Ventures**

The City is a member of the Chelsea Area Fire Authority (the “Fire Authority”), which provides services to the residents of the City of Chelsea, the Township of Lima, the Township of Lyndon, the Township of Sylvan, and the Township of Waterloo. The Fire Authority began operations in June 1999 and the participating communities provide annual funding for its operations. During the current year, the City contributed approximately \$264,000 for its operations. The City is unaware of any circumstances that would cause an additional benefit or burden to the participating governments in the near future. Complete financial statements for the Chelsea Area Fire Authority can be obtained from the administrative offices at 200 West Middle, Chelsea, Michigan 48118.

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2006

### Note 10 - Joint Ventures (Continued)

The City is also a member of the Chelsea Area Construction Agency (the "Agency"), which provides building, electrical, mechanical, and plumbing permits, along with other related services, to the residents of the City of Chelsea, the Township of Dexter, the Township of Lima, the Township of Lyndon, the Township of Sylvan, and the Township of Sharon. The Agency began operations in March 2000 and is a self-funded operation. The City is unaware of any circumstances that would cause an additional benefit or burden to the participating governments in the near future. Complete financial statements for the Chelsea Area Construction Agency can be obtained from the administrative offices at 18027 Old U.S. 12, Suite 100, Chelsea, Michigan 48118.

The investments in joint ventures are recorded in the statement of net assets as follows:

Chelsea Area Fire Authority	\$ 225,532
Chelsea Area Construction Agency	<u>166,448</u>
Total	<u>\$ 391,980</u>

### Note 11 - Contingencies

During 1998, the City was contacted by the Michigan Department of Environmental Quality regarding possible groundwater contamination as a result of a closed municipal landfill. Financial responsibility, if any, for resulting damages will be shared with surrounding townships. The likelihood of loss cannot yet be determined; however, based on investigation by the City's consultants, contamination of the groundwater was not apparent.

The City is currently in a dispute with a vendor over a service agreement related to the Water Fund. At this time, the City has not recognized any liability related to this matter. If an outcome is reached that is unfavorable for the City, the amount may have a material affect on the Water Fund.

## **Required Supplemental Information**

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# City of Chelsea, Michigan

## Required Supplemental Information Budgetary Comparison Schedule - General Fund Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Variance with Amended Budget
<b>Revenue</b>				
Property taxes:				
Real and personal property taxes	\$ 2,266,782	\$ 2,266,282	\$ 2,182,902	\$ (83,380)
Payments in lieu of taxes	351,000	357,800	357,798	(2)
Total property taxes	2,617,782	2,624,082	2,540,700	(83,382)
State sources:				
Revenue sharing	450,000	450,000	429,559	(20,441)
Liquor license fees	4,800	5,100	5,159	89
Total state sources	454,800	455,100	434,718	(20,352)
Licenses and permits:				
Building permits	50,000	52,850	80,431	27,581
Zoning changes	97,000	164,500	169,568	5,068
Total licenses and permits	147,000	217,350	249,999	32,649
Charges for services:				
Recycling	2,000	3,000	3,137	137
Other	5,000	6,500	6,044	(456)
Total charges for services	7,000	9,500	9,181	(319)
Fines and forfeitures	20,000	11,300	11,443	143
Interest	18,000	28,000	26,814	(1,186)
Other revenue:				
Reimbursement	80,000	105,000	116,320	11,320
Sale of property	-	400	400	-
Other	14,316	48,632	73,596	24,964
Total other revenue	94,316	154,032	190,316	36,284
Transfers in	15,000	15,000	15,000	-
Total revenue	3,373,898	3,514,364	3,478,171	(36,163)

# City of Chelsea, Michigan

## Required Supplemental Information Budgetary Comparison Schedule - General Fund (Continued) Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Variance with Amended Budget
<b>Expenditures</b>				
General government:				
Village Council	\$ 19,000	\$ 19,500	\$ 18,394	\$ 1,106
Executive	172,800	172,300	155,397	16,903
Elections	22,300	16,300	14,163	2,137
General and administrative	538,000	625,500	601,308	24,192
Other	63,751	65,551	64,704	847
Total general government	815,851	899,151	853,966	45,185
Public safety:				
Police	1,002,600	1,056,250	1,047,829	8,421
Civil defense	17,360	17,360	16,467	893
Total public safety	1,019,960	1,073,610	1,064,296	9,314
Public works:				
Department of Public Works	568,500	582,000	519,560	62,440
Recycling	25,000	25,000	27,651	(2,651)
Total public works	593,500	607,000	547,211	59,789
Parks and recreation	39,000	54,450	57,032	(2,582)
Planning and zoning	204,375	204,175	191,551	12,624
Employee benefits and insurance	701,212	708,912	666,099	42,813
Total expenditures	3,373,898	3,547,298	3,380,155	167,143
<b>Excess of Revenue Over (Under) Expenditures</b>	-	(32,934)	98,016	130,950
<b>Fund Balance - Beginning of year</b>	155,407	155,407	155,407	-
<b>Fund Balance - End of year</b>	<u>\$ 155,407</u>	<u>\$ 122,473</u>	<u>\$ 253,423</u>	<u>\$ 130,950</u>

# City of Chelsea, Michigan

## Required Supplemental Information Budgetary Comparison Schedule - Special Revenue Fund Major Roads Fund Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Variance with Amended Budget
<b>Revenues</b>				
State sources	\$ 218,000	\$ 218,000	\$ 242,322	\$ 24,322
Interest and other	5,000	40,650	42,526	1,876
Transfers in	338,699	55,511	55,511	-
Total revenues	561,699	314,161	340,359	26,198
<b>Expenditures</b>				
Construction	535,000	502,885	174,740	328,145
Routine maintenance	45,000	89,275	93,711	(4,436)
Traffic services	5,100	10,300	9,293	1,007
Winter maintenance	13,800	12,700	11,762	938
Professional services	1,200	1,200	1,065	135
Surface maintenance	1,000	1,000	59	941
Sweeping and flushing	3,210	3,210	2,977	233
Trees and shrubs	300	300	-	300
Drainage and backsloping	2,200	3,350	2,368	982
Traffic signs and signals	2,760	5,300	5,742	(442)
Winter	4,400	4,350	4,232	118
Miscellaneous	3,240	5,990	4,757	1,233
Total expenditures	617,210	639,860	310,706	329,154
<b>Excess of Revenue Over (Under)</b>				
Expenditures	(55,511)	(325,699)	29,653	355,352
<b>Fund Balance - Beginning of year</b>	788,523	788,523	788,523	-
<b>Fund Balance - End of year</b>	<u>\$ 733,012</u>	<u>\$ 462,824</u>	<u>\$ 818,176</u>	<u>\$ 355,352</u>

# City of Chelsea, Michigan

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## **Note to Required Supplemental Information June 30, 2006**

**Budgetary Information** - The annual budgets are prepared by the City manager and adopted by the City Council; subsequent amendments are approved by the City Council. Unexpended appropriations lapse at year end; encumbrances are not included as expenditures. The amount of encumbrances outstanding at June 30, 2006 is not known. During the current year, the budget was amended in a legally permissible manner.

The budgets have been prepared in accordance with accounting principles generally accepted in the United States of America for the General Fund and all Special Revenue Funds, with the exception that operating transfers have been included in the "revenue" and/or "expenditures" categories, rather than as "other financing sources (uses)."

The budgets have been adopted on an activity basis; expenditures at this level in excess of amounts budgeted are a violation of Michigan law. Comparison of actual results of operations to the budgets of the General Fund and Major Roads Fund, as adopted by the City Council, are included in the required supplemental information of the basic financial statements. A comparison of the actual results of operations to the nonmajor Special Revenue Funds budgets, as adopted by the City, is available at the City offices for inspection.

**Deficits** - The Internal Service Fund had an accumulated fund deficit for unrestricted net assets of \$80,330 at June 30, 2006. The deficit will be eliminated during the year ending June 30, 2007 through charge backs to the appropriate funds of wages, benefits, supplies, and repair and maintenance expenses.

## **Other Supplemental Information**

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# City of Chelsea, Michigan

	Special Revenue			
	Local Roads	Municipal Road Fund	Emergency 911	Drug Law Enforcement
<b>Assets</b>				
Cash and investments	\$ 123,815	\$ 674,056	\$ 147,716	\$ 41,878
Receivables:				
Taxes	-	9,564	-	-
Customers	-	-	-	-
Due from other funds	-	50	-	-
Due from other governmental units	10,372	-	-	-
Total assets	<u>\$ 134,187</u>	<u>\$ 683,670</u>	<u>\$ 147,716</u>	<u>\$ 41,878</u>
<b>Liabilities and Fund Balances</b>				
<b>Liabilities</b>				
Accounts payable	\$ -	\$ -	\$ -	\$ -
Accrued and other liabilities	-	-	-	-
Due to other funds	8,794	-	-	-
Total liabilities	8,794	-	-	-
<b>Fund Balances</b>				
Reserved:				
Law enforcement	-	-	147,716	41,878
Solid waste activities	-	-	-	-
Storm water utility	-	-	-	-
Unreserved and undesignated	125,393	683,670	-	-
Total fund balances	125,393	683,670	147,716	41,878
Total liabilities and fund balances	<u>\$ 134,187</u>	<u>\$ 683,670</u>	<u>\$ 147,716</u>	<u>\$ 41,878</u>

**Other Supplemental Information  
Combining Balance Sheet  
Nonmajor Governmental Funds  
June 30, 2006**

Funds			Capital Project Fund	Debt Service Fund	Total Nonmajor Governmental Funds
Capital Contingency	Solid Waste Facility	Storm Water Utility	Municipal Building	Building Authority	
\$ -	\$ 227,999	\$ 64,213	\$ 267,101	\$ -	\$ 1,546,778
-	2,740	-	-	-	12,304
-	9,586	19,748	-	-	29,334
-	-	-	-	-	50
-	3,365	-	-	-	13,737
<u>\$ -</u>	<u>\$ 243,690</u>	<u>\$ 83,961</u>	<u>\$ 267,101</u>	<u>\$ -</u>	<u>\$ 1,602,203</u>
\$ -	\$ 7,886	\$ 359	\$ -	\$ -	\$ 8,245
-	22,033	806	-	-	22,839
-	-	-	-	-	8,794
-	29,919	1,165	-	-	39,878
-	-	-	-	-	189,594
-	213,771	-	-	-	213,771
-	-	82,796	-	-	82,796
-	-	-	267,101	-	1,076,164
-	213,771	82,796	267,101	-	1,562,325
<u>\$ -</u>	<u>\$ 243,690</u>	<u>\$ 83,961</u>	<u>\$ 267,101</u>	<u>\$ -</u>	<u>\$ 1,602,203</u>

# City of Chelsea, Michigan

	Special Revenue			
	Local Roads	Municipal Road Fund	Emergency 911	Drug Law Enforcement
<b>Revenue</b>				
Property taxes	\$ -	\$ 335,939	\$ -	\$ -
State sources	62,815	-	-	-
Local sources	-	-	18,928	-
Charges for services	-	-	-	-
Interest and other	804	23,014	4,140	1,038
Total revenue	63,619	358,953	23,068	1,038
<b>Expenditures</b>				
General government	1,065	-	-	2
Public works:				
Street construction	4,279	-	-	-
Street routine maintenance	110,771	-	-	-
Traffic services	5,009	-	-	-
Winter maintenance	18,865	-	-	-
Operation and maintenance	-	-	6	-
Total public works	138,924	-	6	-
Debt service	-	-	-	-
Total expenditures	139,989	-	6	2
<b>Excess of Revenue Over (Under) Expenditures</b>	(76,370)	358,953	23,062	1,036
<b>Other Financing Sources (Uses)</b>				
Transfers in	201,763	-	-	-
Transfers out	-	(255,511)	-	-
Proceeds from the issuance of debt	-	-	-	-
Total other financing sources (uses)	201,763	(255,511)	-	-
<b>Net Change in Fund Balances</b>	125,393	103,442	23,062	1,036
<b>Fund Balances - Beginning of year</b>	-	580,228	124,654	40,842
<b>Fund Balances - End of year</b>	<b>\$ 125,393</b>	<b>\$ 683,670</b>	<b>\$ 147,716</b>	<b>\$ 41,878</b>



**Other Supplemental Information**  
**Combining Statement of Revenue, Expenditures, and Changes**  
**in Fund Balances - Nonmajor Governmental Funds**  
**Year Ended June 30, 2006**

Funds			Capital Project Fund	Debt Service Fund	
Capital Contingency	Solid Waste Facility	Storm Water Utility	Municipal Building	Building Authority	Total Nonmajor Governmental Funds
\$ -	\$ 96,260	\$ -	\$ -	\$ -	\$ 432,199
-	-	-	-	-	62,815
-	-	-	-	-	18,928
-	348,068	151,435	-	-	499,503
<u>3,578</u>	<u>7,564</u>	<u>603</u>	<u>1,282</u>	<u>677</u>	<u>42,700</u>
3,578	451,892	152,038	1,282	677	1,056,145
30	225,942	-	-	-	227,039
-	-	-	-	-	4,279
-	-	-	-	-	110,771
-	-	-	-	-	5,009
-	-	-	-	-	18,865
<u>-</u>	<u>199,474</u>	<u>111,197</u>	<u>-</u>	<u>-</u>	<u>310,677</u>
-	199,474	111,197	-	-	449,601
<u>-</u>	<u>13,469</u>	<u>-</u>	<u>72,540</u>	<u>279,728</u>	<u>365,737</u>
<u>30</u>	<u>438,885</u>	<u>111,197</u>	<u>72,540</u>	<u>279,728</u>	<u>1,042,377</u>
3,548	13,007	40,841	(71,258)	(279,051)	13,768
-	-	-	72,290	-	274,053
(375,588)	-	-	-	(57,541)	(688,640)
<u>-</u>	<u>63,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>63,000</u>
<u>(375,588)</u>	<u>63,000</u>	<u>-</u>	<u>72,290</u>	<u>(57,541)</u>	<u>(351,587)</u>
(372,040)	76,007	40,841	1,032	(336,592)	(337,819)
<u>372,040</u>	<u>137,764</u>	<u>41,955</u>	<u>266,069</u>	<u>336,592</u>	<u>1,900,144</u>
<u>\$ -</u>	<u>\$ 213,771</u>	<u>\$ 82,796</u>	<u>\$ 267,101</u>	<u>\$ -</u>	<u>\$ 1,562,325</u>

September 29, 2006

To the Mayor and Members  
of City Council  
City of Chelsea  
305 S. Main Street, Suite 100  
Chelsea, MI 48118

Dear Mayor and Council Members:

We recently completed our audit of the basic financial statements of the City of Chelsea (the "City") for the year ended June 30, 2006. As a result of our audit, we have the following comments and recommendations for your review and consideration.

### **Accounting Items**

#### **Electronic Funds Transfer**

During the year, the City adopted a formal policy related to usage of electronic fund transfers (ACH payments). According to the policy adopted by the Council, the finance manager should sign the ACH warrant, usually the invoice, when initiating the transfer of funds. During our testing, we were not able to note the signoff on the warrant. We recommend that the City review its policy and ensure that all of the steps of the internal control procedures are properly completed.

#### **Disbursements**

The City's long standing disbursement process has the City Council approving cash disbursements after the checks are signed and mailed. Although council members are able to inquire of disbursements made, it does not allow for timely correction of disbursements made in error. Although the director of administrative services and department heads approve invoices for payment, the City should consider adopting a formal cash disbursements policy describing all procedures related to cash disbursements.

#### **Electric Loss**

For the year ended June 30, 2006, the City's Electric Fund had an operating loss of \$226,000 and a shortage of cash as of June 30, 2006. This is in addition to the \$727,000 loss the fund incurred for the 16-months ended June 30, 2005. Although the City had a rate study performed during the year and adjusted the current structure in order for the fund to cover its operation and maintenance, capital and debt related costs, as well as maintaining an appropriate level of working capital, the fund continues to have difficulties in managing cash flows. It has come to our attention that the City has discovered it has been under billing a customer for the past 10 years at a rate of approximately \$200,000 per year. We would encourage the City to develop a plan to check electric meters within the City to ensure they are reading and operating correctly to avoid these billing adjustments in the future.

### **Revenue Sharing**

This year's budget discussion offered hope of an increase in revenue sharing from the last several years. Revenue sharing was identified as a priority by the legislature during its initial budget discussions in the winter and several proposals existed which included a blanket increase in revenue sharing of several percent and one which tied the increase in revenue sharing to local governments who demonstrated that they had engaged in service sharing, service consolidation, etc. In the end, the summer budget comprises that occurred in July saw no increases in revenue sharing over the last several years.

With the appropriation reductions to revenue sharing since 2001 (including approximately \$600 million in fiscal year 2006/2007 over amounts calculated by the statutory formula), a number of townships are no longer receiving any statutory revenue sharing. To accomplish the appropriation reductions mandated in the State's budget, the State is required to reduce the statutory portion of a local unit's revenue sharing, (remember that the constitutional portion cannot be adjusted). Many townships no longer have any statutory revenue sharing remaining as a result. For those communities, because sales tax collections have increased, their revenue sharing is actually increasing because they are now only receiving constitutional revenue sharing. The remaining amount of total statutory revenue sharing in the State's budget (approximately \$400 million) is supporting cities, villages, and larger, urban townships.

The statutory formula sunsets in 2007, so these remaining statutory revenue-sharing dollars will receive considerable attention next year. Next year, the State will also need to begin dealing with counties again as it relates to statutory revenue sharing. In fiscal year 2004/2005, the State eliminated statutory revenue sharing received by counties (which was approximately \$182 million in fiscal year 2003/2004) and, in return, allowed the counties to advance the levy of their operating millage to July from December. The additional monies from the earlier levy were utilized to create a reserve fund by the counties to replace lost statutory revenue sharing. The expectation is that when the reserve funds at individual counties become depleted, the counties will re-enter the State's statutory revenue-sharing formula. It is very possible that the return of county statutory revenue sharing could be at the expense of city, village, and township statutory revenue sharing.

State-shared revenue accounts for approximately 13 percent of the City's total General Fund revenue. The table below details state-shared revenue for the City over the past five years broken out by statutory and constitutional portions. In addition, it details the total decrease in state-shared revenue experienced by the City compared to the State's fiscal year 2000.

<u>State Fiscal Year</u>	<u>Statutory</u>	<u>Constitutional</u>	<u>Total</u>	<u>Increase (Decrease) from 2000</u>
2000	\$ 293,303	\$ 255,694	\$ 548,997	\$ -
2001	265,550	285,395	550,945	1,948
2002	235,042	288,304	523,346	(25,651)
2003	195,837	293,184	489,021	(59,976)
2004	149,510	289,999	439,509	(109,488)
2005	137,797	296,921	434,718	(114,279)
2006	127,920	301,863	429,783	(119,214)

If the State were to eliminate the statutory portion of revenue sharing (as the constitutional portion cannot be modified without a change to the State's constitution), the City has approximately \$128,000 at risk in its General Fund budget based on 2006 funding levels. We will continue to update the City as developments occur.

### **Update on Business Tax Reform**

On August 9, 2006, the Michigan Legislature approved a voters' legislative "initiative" to repeal the Michigan Single Business Tax (SBT) for tax years beginning after December 31, 2007, two years earlier than it was originally slated to end. In addition to the repeal, the law requires the Michigan Department of Treasury to prorate the SBT to result in the equivalent of zero tax on business activity occurring after December 31, 2007. Previously, the SBT was scheduled to be repealed for tax years beginning after December 31, 2009.

Currently, there is no plan for replacement of this \$1.9 billion in lost revenue to the State. If no replacement revenue is identified, statutory revenue sharing may become a target to fill the hole in the State's budget. The legislature has created a "joint committee on economic growth" charged with submitting to the legislature by December 1 recommendations on a replacement tax for the Single Business Tax. Also, ending and replacing the State's personal property tax, a significant revenue source to many local governments, has been added to the committee's agenda.

These matters will receive considerable attention going forward and in 2007.

### **Municipal Finance Act - Reminder**

The Municipal Finance Act was amended several years ago. Communities are now required to submit a filing once a year with the Michigan Department of Treasury. The old 10-day "exemption from prior approval" process has been eliminated and is replaced with this qualification process. This filing will serve as a pre-approval for future debt issues. The current filing is due within six months of the City's year end (December 31, 2006) and is good for one year thereafter. The City should consider the need to file a qualifying statement for each of its component units.

### **Retiree Health Care Funding**

The Governmental Accounting Standards Board recently released Statement No. 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree health care benefits. The intent of the new rules is to recognize the cost of providing retiree health care coverage over the working life of the employee, rather than at the time the health care premiums are paid. These new rules will apply to the government-wide financial statements, rather than the individual fund level. As a result, the City will need to continue to budget for contributions to a pre-funding plan. For many communities, the funding of post-employment benefits is the most significant financial challenge they will face in coming years. The statement will not be effective until the City's 2009 fiscal year. The cost of health care currently paid each year as premiums become due has been increasing and the trend is expected to continue.

We would like to thank the entire City staff for their assistance during the audit. We appreciate the opportunity to serve as your auditors. If there are any questions about your financial report or the above comments and recommendations, we would be happy to discuss them at your convenience.

Very truly yours,

Plante & Moran, PLLC

A handwritten signature in black ink, appearing to read "David H. Helisek".

David H. Helisek